

OMV Q1 2019 Conference Call – Q&A Transcript

OMV published its results for January–March and Q1 2019 on May 3, 2019. The investor and analyst conference call was broadcast as a live audio- webcast at 01:00 pm CEST. Below is the transcript of the question and answer session, by topic, edited for readability.

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OMV Group

Cash flow

Question by **Mehdi Ennebati – Societe Generale:**

On the cash from operations, pre working capital, which came in line with the first quarter 2018. While as you did not sell production from Libya and you received only half-yearly dividend from Borealis, so how have you been able to mitigate those two negative impacts at the cash flow from operations level. Did you receive more cash on your Russian assets than last year? Is your new production from New Zealand or Abu Dhabi more cash generative than your average production? Just would like to understand here please how have you been able to realize such a high cash flow operation?

Answer by **Reinhard Florey:**

Hello, Mehdi. It comes from our very strong operational cash flow that we are producing. So there is no special effect in there that is specifically distorting this number. Just one comment on the Borealis dividend. You said, we have received lower dividend from Borealis. This is true for quarter one. In between 2018 and 2019, there has a decision to split the dividend in two portions, so that we have received also a portion in third quarter in 2018, and we will receive the same also in 2019. You cannot compare the dividend directly between the quarter one dividend of Borealis in that sense. But then regarding the cash flow, of course, you have to take into account that the impact from Libya missing on the cash flow due to the higher tax situation in Libya is of course smaller and the average tax rate that we have seen in quarter one 2019 therefore has been lower, which had a positive impact on the cash.

Gearing

Question by **Michele Della Vigna – Goldman Sachs:**

Certainly it was a very busy year in terms of transaction with Achimov, Sapura, and ADNOC refinery. I was wondering if you could give us an idea where you expect the gearing to be at the end of the year.

Answer by **Reinhard Florey:**

Your question regarding year-end gearing of course is very much dependent on the conclusion of Achimov and at which conditions. So as Rainer has always emphasized, we are in the process of negotiations, and we are still, of course, confident that we will be able to conclude that. This is something where we would still see ourselves eating up a significant part of our headroom that we have against our target, maybe even the whole of it. However, let us be sure we are looking at the gearing currently at a situation where, of course, IFRS 16 distorts these numbers a little bit and we said that we have an impact of 4% to 5% of just from the IFRS 16. So this is not something that we would measure ourselves, again, in 2019, if it comes to the headroom that we have left for our acquisitions. But regards to what exactly the level will be. Let's be surprised when we will be able to give you good news transactions going forward.

Capital Allocation

Question by **Peter Low – Redburn**:

Organic free cash flow generation has been very strong in the past couple of years but that's been somewhat masked by significant inorganic spending. We're now coming to the end of those acquisitions. How do you think about the use of free cash flow going forward? Kind of thinking from a longer-term perspective?

Answer by **Reinhard Florey**:

Regarding the free cash flow use, we have given a set of new priorities actually in the use of our proceeds from our business. Of course, everything, which is I would say, the organic investments, everything that is mandatory in maintenance stays priority number one in order to keep the quality and integrity of all our operations and assets. We have moved up to priority number two the payments in dividends. Why is that? Because we want to be heard very loud and clear about our dividend policy that is progressive dividend policy where our aim is to increase the dividend year by year or at least keep it at the level of the past year. Priority number three is deleveraging. As I have mentioned in my last comment about gearing, you can see that, of course, it will be our target for the near term to regain headroom, again, after successful acquisitions, and therefore, this is priority number three. And then priority number four is the continuation of growth. It's only priority number four because we said actually on big transactions we would take a pause for now as we have a lot to consolidate and bring to the levels of our operational aspiration, and we had been very successful in very short-term about this acquisition. But that's the use of the free cash flow that we will be producing over the next year.

IFRS 16

Question by **Christopher Kuplent – BoA Merrill Lynch**:

On IFRS 16, you're indicating on your slide, there is a positive impact on free cash flow and on CAPEX. Can I add the 2 numbers up to get to an impact on operating cash flows? The decline in the unit OPEX in the first quarter, can you confirm whether or not that is impact IFRS 16 related, I would expect somewhere OPEX goes down and depreciation is going up. So that would be helpful.

Answer by **Reinhard Florey**:

The impact on IFRS 16 is actually one where CAPEX goes up and the reason for CAPEX going up is that, of course, that are always some of these lease contracts going out and some coming in. And of course, you have to then see that the level of the overall net debt where we say, it's around 700 that we did buy more or less 1st of January is coming up. Part of that will then go down, again. But a little bit more will come up in CAPEX. So you cannot add up, the full number of CAPEX to free cash flow impact. Whereas, of course, the free cash flow is a positive one. We said it's EUR 85 mn for the full year, and that more or less comes in from the EUR 90 mn that we see on the operative side as the differential, plus a very small negative impact on net profit of 5, so that's more or less the differential that you have here. In general, you would see, of course, OPEX going down a little bit. But then you also have to take into account, it's not only depreciation that you have, you also have some interest therefore, you see while there's a small positive impact on the operational result, there is a small negative impact on the net result that difference is more or less the interest part.

Question by **Christopher Kuplent – BoA Merrill Lynch**:

Thank you. If I may, can you confirm or not whether the unit OPEX decline in Q1 is not a function of IFRS 16?

Answer by **Reinhard Florey**:

Yes, I can confirm that. Not the function of IFRS 16.

Question by **Bertrand Hodee – Kepler Cheuvreux**:

A follow-up question on Chris' question on IFRS 16 impact. So you've disclosed a lot of impact from IFRS 16 free cash flow, CAPEX. But you did not disclose impact on the operating cash flow and there must be one. So can you give us that number for the full year? And also can you disclose if you have that in mind, if there was any positive IFRS 16 impact on your EUR 1.2 bn operating cash flow in Q1?

Answer by **Reinhard Florey**:

Actually the number that we have given for the free cash flow is the same as for the operating cash flow. There are no deduction in between. So therefore the impact that we are seeing actually is the same EUR 85 mn that I have given you before as impact on the free cash flow. So that's more or less the impact that we are seeing. And that's more or less the ratio that you see compared to what we have on the first quarter impact that we are seeing at the moment. On the CAPEX, we have said it's around EUR 150 mn that will be in addition. But as Rainer had said in his speech, the CAPEX impact is included in our guidance of EUR 2.3 bn operative CAPEX of this year.

Hedging

Question by **Peter Low – Redburn**:

Just on commodity hedging, can you confirm whether you have any hedges in place for either oil or gas volume this year?

Answer by **Reinhard Florey**:

I can confirm that there are no commodity hedges for oil or gas in place on our Upstream side. So we have more or less dissolved the hedge on the gas side in January and therefore, today no hedges in place.

Tax rate guidance

Question by **Henri Patricot – UBS**:

On tax rate and guidance for the full year 2019, whether the guidance for almost 40% still holds and whether we should expect a bit of spike in the second quarter as you sell more from Libya and then slightly lower in the second half of the year assuming stable macro environment.

Answer by **Reinhard Florey**:

Henri, regarding the tax rate. Yes, I can confirm that we keep our guidance on the 40% for the full year up. And it is right that our tax rate, of course, has been more beneficial in the first quarter as we did not have any kind of listings in Libya. As we will catch up at least for the production volumes for almost one month from Q1 in Q2, we can expect the tax rate will be slightly higher in that area, and then we will be on a normal levels, which we estimate to be around 40% for the rest of the year.

Depreciation

Question by **Oleg Galbur – Raiffeisen Centrobank**:

On depreciation. Is the level of EUR 560 mn reached in the first quarter, a good indication for the remaining quarters?

Answer by **Reinhard Florey**:

I think it's very fair to say that there on the depreciation side with acquisitions and additions in capital employed that we had, a good indication for this level to continue for the rest of the year. Of course, if there are further acquisitions and further additions on our capital employed level there will also be additions on the depreciation.

M&A

Question by **Yuri Kukhtanych – Deutsche Bank**:

About Gazprom senior management departures. If you could just comment whether these departures in the beginning of the year, in any way in part the timing or potential timing of the Achimov deal and any other of your activities in Russia.

Answer by **Rainer Seele**:

Well, I do regret of course, Alexander Iwanowitsch Medwedew has left the Board for ever reason but he was replaced by Elena Burmistrova, which I know since an eternity because she was running Gazprom export. We have done really progressive activities together with Gazprom Export. We prolonged our gas contracts with her, we increased our volumes with her. We have done some separate good transactions. So we are very much used to. And now I have to talk to her. Is this in any way delaying our agreement on Achimov IV/V, let me say the risk is there. I agree with you, Yuri, because Elena was not involved when we negotiated Achimov IV/V with Alexander. But this transaction has a priority, and of course, she needs some time to get familiar with that. But I do expect that we are going to find each other on the final terms on the purchase price during the summer, while the summer goes until September from my point of view. That's a late summer because I was born in September, and I see myself I am a late-summer boy. So that's why I think to be fair, yes, potential risk is there. But let's wait and see. I'm a little bit relaxed, Yuri, honestly speaking because the NPV or the value of the asset is really changing in the negotiations, the day we are going to see the first production, and this is anticipated in 2021. Therefore, I do have 2 years left, which I don't want to use. I hope it's only until latest end of summer this year.

Question by **Thomas Adolff – Credit Suisse**:

Thanks for taking my follow-up question. I just want to go back to comment on Achimov. You just mentioned on the call that you expect production to start in 2021. When I go through the transcript from the 4Q results call, you've mentioned production is estimated to start at the end of 2020. Now my question, I guess, is there a delay on Achimov? Or have you just simply rounded it down to 2021?

Answer by **Rainer Seele**:

All right. Well, Thomas, now we can discuss whether it's 31st of December or 1st of January. Now I don't do that. We don't see any delay in the project, yes. We just have said there can be a swing into the first quarter of 2021, that's why I am more on the safe side. Given the fact that I am negotiating now Achimov IV/V, you might understand that I see it in the negotiation more in 2021 than in 2020.

Upstream

SapuraOMV

Question by **Thomas Adolff – Credit Suisse:**

Regarding SapuraOMV, I know it's only been a few months but now that you sit inside of the company, perhaps you can talk about your first impressions of SapuraOMV.

Answer by **Rainer Seele:**

I would like to headline it, lower costs and higher production than planned. So the company looks much better from our operational point of view than we have anticipated when we negotiated the terms to enter Sapura, what we see is that a major priority has now financing of the projects, we do have in the pipeline. We will speed up the projects, and we have really a very welcome situation in the company because we would like to bring in now our development expertise, especially, when it comes to higher CAPEX spending. We should in conclusion say, we don't regret that we have done such a good deal.

Libya

Question by **Mehdi Ennebati – Societe Generale:**

Regarding Libya, so the production restarted and you are now approaching close to plateau. I would like to know if you are able to export the crude from Libya in an optimal way in order to avoid being surprised "(inaudible)". And can you also make an update regarding the situation at El Sharara oil field. There are some information saying that it might have been shut and can you also make us an update regarding the Zueitina oil terminal. So who is also controlling the Sharara oil field and who is controlling the Zueitina oil terminal, please?

Answer by **Rainer Seele:**

We have no impact on our operations in El Sharara so far, since we restarted the production; everything is running smoothly, without any interruptions, no technical problems, and no security problems so far. So knock on wood, we also can export the crude, and as I have said, we have sold already some cargoes from our Libyan production. So that we have no restrictions as we speak about the situation. I don't know how I should answer your question, who is controlling what in Libya. I don't know how I should answer on this. All I can say is, the situation around our production sites in Libya hasn't changed, and everything is safe. The security guards are the same. We have no interference from political point of view. So therefore, from my point of view, we are expecting that although, the situation in Libya is pretty fragile. We are expecting that we are going to see a stable production also in the second quarter.

Question by **Josh Stone - Barclays:**

I would like to follow-up on Libya. You had an under-lifting position at 1Q. Do you expect to get those volumes back? And do you think you can actually move into an over-lifting position at 2Q, and trying to get back some of the lost sales volume at 1Q.

Answer by **Rainer Seele:**

Well, you're absolutely right. We have produced some oil in the first quarter, which we could not market and not export from Libya. This oil is moving into the second quarter. Definitely this has a positive impact on Q2.

Question by **Alwyn Thomas – Exane BNP Paribas:**

Is the EUR 140 mn impact from Libya for the quarter generally a good benchmark for future quarters?

Answer by **Rainer Seele:**

The EUR 140 mn is not a benchmark for the next quarters. It really depends how much liftings we are going to see in Libya, and that's determining the impact. All I have said is that, a little bit of the Q1 is now moving into Q2. That's all I can give you as a guidance, which tells you in Q2 it must be at least EUR 145 mn, instead of EUR 144 mn, which we have seen in the Q1.

Gas prices

Question by **Josh Stone - Barclays:**

On the gas realizations, they have clearly held up despite the fall in hub pricing. You mentioned the lag effect and also Romanian gas pricing. I would have thought the direction 2Q would be down given that lag effect. Perhaps you can help us understand the magnitude of that decline? Some of the moving parts there and if there's any dates of April you can provide, could be helpful as well.

Answer by **Rainer Seele:**

When we talk about the gas lag effect, you're also right, yes, with the 2-month time lag effect, we do have on our gas prices and given the fact that Q1 gas prices were below the Q4 gas prices of 2018. There are lower gas prices awaiting us in the second quarter.

Question by **Josh Stone - Barclays**:

Presumably, you can't help us understand the magnitude of the decline. I guess we can figure that out.

Answer by **Rainer Seele**:

I think you have to run your calculation yourself.

Production guidance

Question by **Thomas Adolff – Credit Suisse**:

Just go into 2019 production guidance of about 500,000 bbl/d and in your press release and in your presentation, you said, that requires at least 35,000 bbl/d from Libya. And so it is fair to say that you are running with a fairly limited contingency buffer for the rest of the year. And if there is a contingency buffer, how big is it, perhaps you can talk around that?

Answer by **Reinhard Florey**:

Thomas, regarding your first question on the 500,000 barrels. We clearly see in first quarter, we missed out on the 500, however, with things going the right way, we are expecting to be able to have the production around 500,000 for the rest of the year. Now we are estimating the 35,000 barrels from Libya that's not unrealistic. If there are no interruptions with the fields that we have in the Eastern and the Western side from Libya together, we are at the level of producing 35,000 bbl/d as there is no need for contingency in there. If you would ask for how much contingency above the 500,000 we have, we are not guiding under the impression of contingencies. So we think this is a fair assessment on how our production currently runs. And this is the way how we also would like to give the message to you. So don't think we are hiding any contingencies in our guidance there.

Question by **Yuriy Kukhtanych – Deutsche Bank**:

Congratulations for the results. I think they are excellent given the environment in Q1. Around your production, there were some issues in Aasta Hansteen, there was a pipeline leakage, production was shut there. If you could just update us on the current situation and also in Romania, it seems like production decline is accelerating in the past 2 quarters. So I was just wondering, how are you feeding these 2 events into your 2019 average production guidance, so 500,000 bbl/d.

Answer by **Rainer Seele**:

Yuri, as to speak about the production in Romania, you're absolutely right that we are now estimating a higher decline rate. Given the unfavorable changes of the framework of the Romanian government, especially, the gas price cap, the decline rate, which we formally guided was 3% per annum, we are now expecting a 5% decline rate per annum. This is one of the consequences we have to swallow because we have reduced our CAPEX program. We had to reduce our CAPEX program in Romania because some of the gas projects given the new regulatory framework did not calculate a positive rate of return for us. And that's the reason why Petrom management decided to reduce the CAPEX program for 2019, and that's why you do see a higher decline rate in Petrom than we have guided in the past.

Answer by **Reinhard Florey**:

Yuri, on Aasta Hansteen, you're right, there has been a short shut in, in order to repair leakage of a valve, which is actually not a total unusual thing if you have new startup. That these things will have to be fixed over the time. I can confirm that Aasta Hansteen has been brought up again and is producing.

Question by **Alwyn Thomas – Exane BNP Paribas**:

I want to ask on production, going into the summer months and into 2Q. Outside of Libya returning. Can maybe just discuss some of the moving parts particularly on the Russian gas volume. Are you expecting that given weaker gas prices in Europe, whether there might be more than usual sort of seasonal impact there?

Answer by **Rainer Seele**:

We have normal seasonal impact in summer and annual maintenance in the third quarter, so that's the reason why we are going to see a lower production level in Yuzhno Russkoye in the summer quarters. But this is a typical profile we have every year. That's also we are guiding 100,000 bbl/d in average for the total year. It's a little bit more in the winter quarters, Q1 and Q4 and a little bit less in the summer quarters. That's a normal profile. By the way, fully in line with the consumption in the market. You don't do me the favor you heat your house in the summer. I would supply the gas to you but you don't want it. And that's the reason why we have such a profile.

Question by **Alwyn Thomas – Exane BNP Paribas**:

Okay, but there is no, just to be clear, you don't expect any specific impact just because gas prices in Europe have been weaker?

Answer by **Rainer Seele**:

No.

Question by **Oleg Galbur – Raiffeisen Centrobank:**

In Emirates, you recorded the quarter of 22,000 bbl/d and if I remember correctly, I might be wrong, the level guided for this year was 30,000 barrels. So if that is the case, could you tell us when do we expect to reach this level?

Answer by **Rainer Seele:**

Your question, Oleg, on the United Arab Emirates, we can't give you an indication for 2019. All we have said so far is that we're expecting to see the plateau production, which will be 43,000 bbl/d in 2023. So we will have a step up in the production, yes, but the years in between, we're not giving any guidance.

Neptun

Question by **Henri Patricot – UBS:**

If you can give us an update on the discussions in Romania regarding the regulatory environment and what it means for possible FID of Neptun Deep.

Answer by **Rainer Seele:**

Well, on Romania, our local Petrom management is in a very intensive deep dialogue with the Romanian government with different ministries, and we are definitely seeing a little bit of progress. If we remember, the gas cap for the next 3 years has been reduced as an impact to the market, limited to a lower market segment. So I would say that's all the positive news I can give you, Henri, and because it's only this, it's not enough to go for a positive FID. We need to have further fiscal stability, especially, a clear commitment of the Romanian government to a liberalized market, and of course, we also need the key infrastructure in place. I know that the tender for the ROHU pipeline will expire end of this month. So therefore, I hope we will have more clarity, if not there has to be a further prolongation of the tender for these capacities. And it takes two to tango, we have a partner Exxon who also has to say yes. We are fully aligned with such a partnership and right now, the regulatory framework and the fiscal framework, we see on the table is not sufficient to initiate or to start our approval process internally. Your question when it will be, this is a crystal ball, which is pretty foggy at the moment, yes. It all depends not on us, it depends really on the Romanian government to come up with a satisfying framework for us.

Downstream

Margins

Question by **Jason Gammel – Jefferies:**

You've obviously been able to preemptively schedule all your maintenance to be able to run full for the back half of the year and into 2020. Can you give us some idea of when you think we might start to see wider spreads and stronger cracks on middle distillates that are related to IMO and is that something you built into the margin forecast for this year?

Answer by **Rainer Seele:**

The cracks on middle distillates, if I would have known this, but first of all when you look into the first quarter, into the first quarter, we have seen there was a real oversupply in the market from benzene and naphtha as well. We benefited from naphtha in our petrochemical business, but we have seen now that there are higher calls for benzene, but lower calls for diesel. What I am expecting is that in the second quarter, we might see a higher demand especially in Europe picking up, absorbing a little bit the oversupply situation we see with middle distillates in the market. Do I see there quick and a very strong return in middle distillate margins, definitely it will depend on the situation in the U.S. and in Asia because right now we see high imports, especially, from the United States into the European markets as demand there is pretty low. The question on IMO. We see now, IMO really moving into the market, which says lower call for heavy fuel oil. So we don't see it as a shift to the other product groups. All we see is that the market is asking for less HFO and therefore, we do see very low cracks in prices in the HFO market. This will continue. We're expecting and calculating with positive IMO margins in the fourth quarter on a very, very low level and as the new regulation will come in force on 1st of January, next year, I think it would start with 2020.

Question by **Jason Gammel – Jefferies:**

There has obviously been some interruption in Russian pipeline oil being delivered recently. I don't think it directly affects your crude supply, but has it had any effect on your crude sourcing and pushing up Urals prices that could negatively affect the 2Q margin?

Answer by **Rainer Seele:**

First of all, we are not impacted by the situation at all because we get all our crude via our cargoes in Trieste and that's the supply route for our refinery. So we are not impacted. That I agree with you as I have seen no real clear message in the market, how long the situation will last. It might have an impact in the mid-to long-term on the Urals differential, which was already a pain in the neck in the first quarter. One of the reason why our refining margins we have seen in Europe is that the Urals differential was not in favor especially for the Eastern European refineries, yes? So that's something, which might give another downside for the refining margins in Eastern European countries. Especially, we have to see that the heavier crude globally is now running short, given the fact that the sanctions on Venezuela and Iran are really reducing this quality and is increasing the call for crude from Russia.

Nord Stream 2

Question by **Michele Della Vigna – Goldman Sachs:**

And also I was wondering, if you could walk us through the progress in the Nord Stream 2 project.

Answer by **Rainer Seele:**

Michele, on Nord Stream 2, first of all, I have to say, we are within time and plan with the project, which says also within budget, we have now financed, including the Q1 contribution, EUR 640 mn as OMV share. The project now, I think I work a little bit on the progress because you read so many numbers, how many kilometers are already constructed. Right now, 1,100 kilometers of the pipeline, of the two lines are constructed. As we are building 2 lines, each around 1,200 and let's say 50 kilometers is a bit less, but let's say 1,250. So in total 2,500 kilometers of Nord Stream 2, two lines have to be built. Given that we have now built 1,100 something between 40% and 45% of the pipeline has been laid already. We have moved now our laying activities into the Russian waters. We are going to construct in the next week around 100 kilometers in the Russian sector and connecting, especially, with the injecting point in Vyborg. So that we are going to have the first section more or less in place. The main topic on our agenda as we speak about, what do we need to finalize the project is the remaining permit from Denmark. As you have seen in the press, Nord Stream 2 company has delivered the environmental impact assessment study for the third line. We have now three routes to be discussed with the Danish authorities. I'm now calling for a quick decision from the Danish authorities. They know the projects since an eternity already. On a nondiscriminatory basis, I expect to see that decision coming as early as possible, so that we do know, which laying barge we have to send where so that we can connect the two pieces of the pipe. As we speak about the third energy package with the amendments, we have to wait and see how this is going to be implemented into German law then I can give you an idea what kind of impact this will have on the project.

Borealis

Question by **Christopher Kuplent – BoA Merrill Lynch:**

On the Borealis dividend that you highlighted being split into two payments. Is it a 50-50 split, do you already know how much is coming back to you in the third quarter?

Answer by **Reinhard Florey:**

That's not necessarily the case that we have a 50-50 between the first and the third quarter, this very much depends also on the operational performance and the investment plans of Borealis. So therefore we are guiding only on what we have seen for Q1, but that is, of course, something to be expected in Q3.

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